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No. 366

# In the Supreme Court of the United States

OCTOBER TERM, 1960

HOMER H. AND INA MAE MARSHMAN, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT*

## MEMORANDUM FOR THE RESPONDENT

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## MEMORANDUM FOR THE RESPONDENT

This case and *Estate of Gordon A. Stouffer, Deceased, Mark A. Loofbourrow, Executor* v. *Commissioner,* 30 T.C. 1244, were tried on a single record in the Tax Court.[1] Pursuant to stipulation of the parties, the cases were consolidated on appeal. The question presented in the instant case is the correct basis of certain Stouffer Company stock in the hands of Ina Mae Marshman. The answer to this question turns upon whether her former husband, Gordon A. Stouffer, realized taxable gain when, pursuant to a

[1] Gordon A. Stouffer and Ina Mae Marshman were husband and wife until their divorce in 1951. For protective reasons, the Government, contemporaneously with the filing of this memorandum, is filing a petition in the companion *Stouffer* case.

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divorce settlement, he surrendered a valuable option to purchase this stock in return for Ina Mae's release of her right to support and to share in his property at his death. If Gordon realized taxable gain, Ina Mae's basis would be increased by the amount of such gain. If he did not, the adjusted basis of the shares in her hands would be correspondingly less.

The Court of Appeals, reversing the Tax Court, held (Pet. 20–33) that, although Gordon may have realized economic gain, he did not realize taxable gain under the provisions of Section 111(b). Its reason for this conclusion was that it was not possible to measure the fair market value of the property received by him in exchange for surrendering the option.[2] In holding that Gordon realized no taxable gain, the Sixth Circuit expressed disagreement with *Commissioner* v. *Mesta*, 123 F. 2d 986 (C.A. 3d), certiorari denied, 316 U.S. 695, and *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C.A. 2d), certiorari denied, 319 U.S. 741, which establish the rule (and apply it

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[2] Section 111 of the 1939 Code provides:

"SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

"(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

"(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

* * * * *

(26 U.S.C. 1952 ed., Sec. 111.)

to property settlements incident to divorce) that the value of property received should be measured, in the absence of other evidence, by the value of property given in exchange therefor.

The *Mesta-Halliwell* rule—which we think correct—rests on the practical assumption that a man who gives property of a fixed value for an unliquidated claim receives his money's worth. That rule or principle has been widely accepted and is of considerable administrative importance. Thus, it has been used to appraise stock received in exchange for assets (*Maine Steel, Inc.* v. *United States*, 174 F. Supp. 702, 714 (D. Me.); *Arco Manufacturing Corp.* v. *Commissioner*, 27 T.C. 547, 556); it has been the basis for determining whether a transfer in satisfaction of an unliquidated claim is for adequate and full consideration in money or money's worth or is properly a gift (*Commissioner* v. *Patino*, 186 F. 2d 962 (C.A. 4th); *Beveridge* v. *Commissioner*, 10 T.C. 915); it was applied by the Second Circuit in *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310, which held that the taxpayer had realized taxable gain when it used appreciated property to pay unliquidated bonus awards to employees.

Indeed, the Sixth Circuit itself has applied the *Mesta-Halliwell* principle in a case more recent than the instant one (see the opinion in *United States* v. *General Shoe Corp.*, reprinted in the Appendix, *infra*, pp. 7–16), though, in that case, the court regarded the situation as distinguishable because it did not involve a settlement incident to divorce. The question in *General Shoe* was whether the taxpayer

corporation realized taxable gain when it contributed appreciated property to an employees' retirement trust. In holding, as urged by the Government, that the corporation realized taxable gain to the extent that the property contributed had appreciated over its adjusted basis, the Sixth Circuit approved and followed *International Freighting Corp.* v. *Commissioner, supra,* which had reasoned that the consideration received must be deemed to be no less than the value of the property given. The court below found the situation presented in *General Shoe* distinguishable from that presented in the instant case, however, the ground of distinction being that *General Shoe* involved an arm's-length transaction uncomplicated by intangible, personal, and emotional factors.[3]

As matters stand, therefore, it appears that there is conflict between the Sixth Circuit and the Second and Third Circuits, but that the conflict is confined to transactions typified by husband-wife property settlements.

There is a further factor present in the instant case. The primary holding, as noted above, is that the husband's release of a valuable property right which had appreciated did not admit of a determination of capital gain because the *quid pro quo* received—the wife's release of unliquidated claims—is not susceptible of valuation. There is, however, a secondary holding. The court below also concluded (Pet. 32):

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[3] We invite attention to the fact that the Sixth Circuit's determination in *General Shoe* is not yet final. The taxpayer filed a petition for rehearing *en banc* and the Government, upon request of the court, has filed a response. The petition for rehearing is now *sub judice.*

> Even if we accept the ruling of the *Mesta* case that the fair market value of the release is the same as the fair market value of the option, it is impossible to tell from the evidence in this case what the fair market value of the option was.

We disagree with this holding because we do not think that the appellate court had an adequate basis for rejecting the Tax Court's finding that the parties had established the value of the option through arm's-length bargaining.[4] Nonetheless, we recognize that this issue is one confined to the peculiar facts of this case.

In sum, we believe that the court's primary holding represents a conflict with holdings in two other circuits. For this reason, we do not oppose grant of the writ. At the same time, we believe that the significance of this case is somewhat muted—*first*, because the *General Shoe* decision indicates that the area of

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[4] Ina Mae and Homer H. Marshman, Ina Mae's attorney at the time of the settlement, both testified that Mr. Loofbourrow, Gordon's attorney, had told them that the option was worth $360,000; that they both agreed that the option was of this value; and that they thought $360,000 was a fair settlement of her rights in an estate which would one day be worth a million and a half or two million dollars. (R. 44a–49a, 67a–69a.) The Tax Court heard these witnesses testify and believed them. (R. 105a.) Exhibits 17 and 18, prepared by Gordon's attorneys, clearly show that Gordon was negotiating on the basis that the option had a value of $360,000. Thus, at the time of the settlement agreement, all parties agreed to a value of $360,000. The Court of Appeals, in reversing the Tax Court's finding and in holding that there was a *bona fide* dispute as to the validity of the option at the time the settlement agreement was entered into, relied upon the testimony of a former attorney of Ina Mae who did not represent her at the time of the final settlement negotiations.

conflict is a circumscribed one; *secondly,* because the court below has also rested upon an alternative ground of decision. We recognize that in these circumstances this Court might well conclude that the instant case does not offer the most appropriate vehicle for resolving the issue as to which there is a conflict.

Respectfully submitted.

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OCTOBER 1960.

# APPENDIX

## United States Court of Appeals for the Sixth Circuit

### No. 13914

UNITED STATES OF AMERICA, PLAINTIFF-APPELLANT

*v.*

GENERAL SHOE CORPORATION, DEFENDANT-APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF TENNESSEE

Decided September 2, 1960

Before MCALLISTER, *Chief Judge*; POPE, *Circuit Judge*; and THORNTON, *District Judge*.

THORNTON, *District Judge*. The facts in this tax case are not in dispute in any degree[5] important to disposition on appeal.

The issue here for determination is new to this Court except perhaps for an apparent similarity between it and that present in a case decided by this Court May 31, 1960.[1] We believe that there is a distinction of a fundamental nature between that case and this one. We shall advert to this distinction later on in this opinion.

For purposes of this appeal, a broad outline of the facts will suffice. In view of our treatment of the problem, we deem it unnecessary to go into the details which the District Court necessarily had to include in his findings of fact and conclusions of law. We affirm those findings. They constitute an excellent

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[1] *Commissioner of Internal Revenue* v. *Marshman et al.*, * * * F. 2d. * * *.

presentation of the factual background which revolves around the plan of appellee, hereafter referred to as the taxpayer, to create a pension or retirement trust for the benefit of its employees. The taxpayer did, in fact, execute such a plan which consists of a trust to which the taxpayer contributed assets. We are here concerned with assets contributed during the fiscal years 1951 and 1952, and taken as deductions by the taxpayer on its corporate tax returns for such years. These assets consisted of two parcels of real estate located at or near Atlanta, Georgia, appraised at $160,000 and $250,000, respectively, at about the time of the contributions. Another parcel in Atlanta was contributed, and its value was determined to be $37,500 (based on the sale of it by the trust). The last such contribution with which we are concerned is real estate located at Huntsville, Alabama, and appraised at $600,000. The appellant, hereafter referred to as the Government, put in issue by amended answer (1) these market values, (2) whether they were actually contributed to the trust during the taxable years for which deductions were taken, and (3) whether the trust was a qualified trust "exempt from taxation under Section 165(a), Internal Revenue Code of 1939, so that contributions are deductible under Section 23(p)." The District Court found, and we think correctly, for the taxpayer on all three questions. The Government accepts such findings for purposes of this appeal so we will not concern ourselves with them. We observe, however, that these findings have been most carefully prepared.

In its conclusions of law, the District Court concludes as follows, and we quote the six paragraphs comprising the conclusions:

CONCLUSIONS OF LAW

1. The Court has jurisdiction of the parties and subject matter herein by virtue of Section 7422 of the Internal Revenue Code of 1954, and Sections 1340 and 1346, Title 28, United States Code.

2. Plaintiff's Employees Retirement Trust complied with the provisions of Section 165(a) of the Internal Revenue Code of 1939, with the result that contributions to the trust by plaintiff in the years ending October 31, 1951 and October 31, 1952, respectively, were properly deductible under Section 23(p). The law does not require that the employer have a legal obligation to make contributions to a trust in order for the trust to be exempt. *Lincoln Electric Co. Employees' Profit Sharing Trust, et al.* v. *Commissioner of Internal Revenue* (C.A. 6, 1951), 190 F. 2d 326. Having made no misrepresentation to the Treasury Department, it was an abuse of discretion to rule in 1958 that the plan and trust did not conform to Section 165(a). *H. S. D. Co.* v. *Kavanagh* (C.A. 6, 1951), 191 F. 2d 831. The ruling letter of February 11, 1958, holding that the plan does not meet the requirements of Section 165(a) of the 1939 Internal Revenue Code of Section 401(a) of the 1954 Code and that the trust is not qualified under said sections and is not exempt from taxation was based on an erroneous view of the law and is of no effect.

3. The plaintiff was entitled to the deductions on its income tax returns for the years ending October 31, 1951 and October 31, 1952, respectively, representing the fair market values of the properties contributed to the trust, to wit: $160,000 for the Lawrenceville, Georgia property and $250,000 for the Caroline Street, Atlanta, property, in 1951, and $37,500 for the Yonge Street, Atlanta, property, and $600,000 for the Huntsville, Alabama property in 1952.

4. Section 111(a), Internal Revenue Code of 1939 provides that the "gain from the sale or other disposition of property" [which is included in the definition of "gross income" contained in Section 22(a)] "shall be the excess of the amount realized therefrom over the adjusted basis. * * *" Section 111(b) provides:

"Amount Realized. The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

In contributing these properties to the trust, the plaintiff did not receive any money, and did not receive the equivalent of money since no debt or legal obligation was discharged; it did not receive any "property" having "fair market value" within the meaning of said section; and hence there was no "amount realized" from the contributions to the trust. That being the case, there was no taxable gain.

5. The case of *International Freighting Corporation* v. *Commissioner of Internal Revenue*, 2d Cir., 135 F. 2d 310, relied on by the defendant, should not in the opinion of the Court be followed or applied in the present case. A careful analysis of the opinion in that case compels the conclusion that the Court lost sight of the statute requiring as a prerequisite to liability for a capital gains tax receipt by the taxpayer of either "money" or "property." The decision was based upon the court's theory of consideration, which theory itself is subject to question, rather than upon the receipt of "property" as required by the basic statute. It is not contended, of course, that the taxpayer received "money," nor is the Court able to find from the facts of the case that it received "property" within the meaning of the statute, whatever may be said about consideration. While the decision of the Court of Appeals of another circuit is persuasive, it should not be

followed where it is clear that the decision itself constitutes a departure from the controlling statute.

6. Plaintiff is entitled to judgment for the amount of taxes paid by it as the result of the erroneous assessment of capital gains taxes on the contributions of real estate to its Employees Retirement Trust, plus the interest paid by plaintiff on said amount, and also for interest as allowed by law, and for allowable costs.

We find ourselves in complete agreement with the District Judge in his conclusions of law numbered 1, 2 and 3. We think the law is clearly to the effect that a pension or retirement plan such as was here established complied with the Code so as to enable the taxpayer to deduct [under Section 23(p)] contributions made by the taxpayer to the trust. The fact that the taxpayer was not obligated in this respect does not preclude it from taking the deduction, nor the trust income from being exempt from taxation. The District Court made proper conclusions of law in this respect. This Court, in *Lincoln Electric Co.* v. *Commissioner*, 6 Cir., 190 F. 2d 326, determined the *exemption* issue, and in *Lincoln Electric Co.* v. *Commissioner*, 6 Cir., 162 F. 2d 379, determined the *deduction* one in opinions written by Judge Simons. In an opinion written by Judge Miller of this Court in 1950,[2] the same reasoning is applied as in the earlier *Lincoln Electric* case cited, and the same conclusion is reached re deductibility from gross income as an ordinary and necessary business expense.

It is with the conclusions of law numbered 4–6 that we find ourselves in disagreement with the court below, and as to which we must reverse.

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[2] *Commissioner* v. *Surface Combustion Corp.*, 6 Cir., 181 F. 2d 444.

A few details of factual background as to the capital gains feature of the case, as distinct from the trust-contribution-deduction feature, are here in order. When the taxpayer made the real estate contributions to the trust, it took deductions on its corporate income taxes in the amounts of the appraised values of these properties. These deductions were allowed, but a capital gains tax was assessed, measured by the difference between the assessed valuation (or fair market value) and the basis. The taxpayer paid these capital gains taxes and filed timely claims for refund. Said claims were disallowed and this action is the result. The District Court agreed with the taxpayer that it had not realized a *taxable* capital gain. We believe that this was an erroneous view of the law. We think that the rationale of *International Freighting Corporation* v. *Commissioner of Internal Revenue*, 2d Cir., 135 F. 2d 310 is persuasive. We recognize, of course, that the decision there is not controlling, and we do not here hold that the court below was bound by it as such. We can hardly state the rationale of that decision better than Judge Frank did in his short succinct opinion in *Freighting*. When the taxpayer *here* made the contributions to the trust it was entitled to take, and did take deductions for such contributions as "ordinary and necessary" expenses. When the taxpayer evaluated the contributions on the basis of the then current market value and used those figures for its deductions, it then realized capital gain to the extent that such values exceeded its basis. There is no gainsaying this logic. The tax statutes do not operate in theory—they are practical. The disposition of the real estate by the taxpayer resulted in an "amount realized" within the meaning of Section 111(b)—

> Amount Realized. The amount realized from the sale or other disposition of property shall

> be the sum of any money received plus the fair market value of the property (other than money) received.

The taxpayer realized exactly the same gain here by transferring the real estate as it would have had it sold the real estate for the fair market (or appraised) value and contributed the funds to the trust. Would the taxpayer say that if it had sold the real estate that there would have been no taxable capital gain in this situation? Can a taxpayer circumvent the capital gains tax by such a simple device? In *Helvering* v. *Horst*, 311 U.S. 112, 115 the court says that "Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him." In *Lucas* v. *Ox Fibre Brush Co.*, 281 U.S. 115, 119 Mr. Chief Justice Hughes, directing his attention to the issue of the reasonableness of extra compensation for work done, referred to payments made "as a matter of internal policy having appropriate regard to the advantage of recognition of skill and fidelity as a stimulus to continued effort." Surely the same considerations are present in relation to a plan whose purpose is as stated in the present case:

ARTICLE I: PURPOSE

> The purpose of this Plan is to provide for the accumulation of a fund to pay annuities to regular employees of the Corporation upon retirement because of age or disability after a period of faithful service with the Corporation, and to supplement the benefits provided under the Federal Social Security Act.

The theory of economic gain comes into play. To argue, as the taxpayer does here, that there can be no gain because nothing is realized, is unrealistic. Lit-

erally the taxpayer is correct in its contention that it did not receive a tangible benefit * * * however, we do not conceive that in this day and age we are restricted to tangibles in tax matters where there is actual recognizable benefit, albeit intangible, the taxation of which is implicit in the statutory scheme, and where such benefit is clearly capable of being evaluated on an objective basis. It is at this point in our discussion of this case that we deem it pertinent to distinguish the *Marshman* case decided by this Court May 31, 1960. The differences are fundamental and the similarities superficial. The instant case and the *Marshman* case have a common meeting ground retroactively, so to speak. In no respect do we believe there exists any real conflict. The retroactive meeting ground is *Freighting*[3] for the reason that it presents a factual picture closely analogous to the one here. It cites in support of its legal conclusion re taxable capital gain the *Mesta*[4] and the *Halliwell*[5] cases, and also *Kenan* v. *Commissioner*, 2 Cir., 114 F. 2d 217. In *Marshman*, *supra*, this Court disagrees with *Mesta* and *Halliwell*, those cases having dealt with property settlements in divorce actions. The *Kenan* case is not subject to the same infirmity, however, and is valid support for the taxable gain rationale in *Freighting*, which has direct application to the instant case. We reiterate what Judge Miller of this Court said in *Marshman* that if the property *received* "has no fair market value, or if such market value has not been shown, it may be economic gain but it is not taxable gain by reason of the express provision of Section 111(b)." *Marshman*, as well as *Mesta* and *Halliwell*, involved a property settlement in a

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[3] Supra, 135 F. 2d 310.

[4] *Commissioner* v. *Mesta*, 3 Cir., 123 F. 2d 986.

[5] *Commissioner* v. *Halliwell*, 2 Cir., 114 F. 2d 217.

divorce action. Quoting from Judge Miller's opinion again:

> A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal and practical considerations which play no part in a transaction between a willing seller and a willing buyer in the open market. The value of what is given up is no criterion of the fair market value of the "property" received.

The truth of this observation is, of course, readily apparent. How different are the facts here. The value of what was given up here bears a direct relationship to the fair value of the "property" received. The "property" received is an economic gain to the taxpayer of exactly the market or assessed valuation which the taxpayer used as a deduction on its income tax returns. Again, in the *Marshman* case, this Court cites *Helvering* v. *Horst, supra* and points out that the Supreme Court there was dealing with "the *realization* of economic gain, not the *valuation* of such gain." The difficulty inherent in the application of the economic gain theory in *Mesta*, in *Halliwell*, and in *Marshman* is directly related to the *valuation* of the gain rather than its *realization*. That difficulty is readily overcome in the matter herein. This is an arm's length situation. Emotional factors are not involved. The measurement of the intangible benefits is easily reduced to dollars and cents. We do not here have the *Marshman* "insurmountable obstacle to the application of Section 22(f) in conjunction with Section 111(a) and (b)." We experience no difficulty in accepting as the fair market value of the property received by the taypayer the appraised valuation which the taxpayer took as a deduction on its income tax returns. This is consistent with the statement of Judge Miller in *Marshman* that "Under long estab-

lished rulings fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell. * * * A single transaction between a husband and wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule." We have quoted the foregoing in order to point up the width of the gulf between the considerations entering into *valuation* of transfers made in cases like *Mesta, Halliwell* and *Marshman* compared to the valuation of those effected in *Freighting* and in the instant case.

In accordance with the foregoing reasoning, we are of the opinion that the determination of the District Court that the taxpayer did not realize a taxable gain when it made the transfers and took the deductions for their fair market value was an erroneous one. The decision is therefore reversed and the judgment of the court below vacated.